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Bosnia and Herzegovina: Supplementary Letter of Intent Policies, and Technical Memorandum of Understanding

Press Release:
[IMF Executive Board Completes Fifth Review Under the SBA for Bosnia and Herzegovina, Extends and Augments the Arrangement, and Approves €48 Million Disbursement](#)
January 31, 2014

January 8, 2014

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Supplementary Letter of Intent

Sarajevo and Banja Luka, Bosnia and Herzegovina

January 8, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Lagarde:

1. The Stand-By Arrangement (SBA) for Bosnia and Herzegovina (BiH) approved in September 2012 by the Executive Board of the International Monetary Fund (IMF) continues to anchor our economic policies in a challenging environment. We remain committed to implementing the policies described in our Letter of Intent dated September 11, 2012, as well as to the policies described in our Supplementary Letters of Intent of December 6, 2012, April 23, 2013, June 12, 2013 and October 9, 2013. This Supplementary Letter of Intent provides information on our efforts and achievements since the completion of the fourth review under the arrangement in October 2013, as well as on the additional policy measures we plan to undertake in 2014 to help ensure that the objectives of the SBA continue to be met. Moreover, as the arrangement is currently set to end in September 2014, we would also like to request an extension and augmentation of the arrangement until June 30, 2015. With general elections planned for October 2014, an extended arrangement would continue to provide a valuable anchor for economic policies during the period of the elections and government formation, while it would also help us address the additional financing needs we expect for 2014 (see paragraphs 5 and 19).

2. Growing external demand and reduced financial market stresses in Europe, together with our prudent economic policies, have helped to sustain the modest recovery that started in early 2013. Exports continued to lead the recovery, and high frequency indicators suggest that the pick-up in economic activity is becoming more broad-based. Therefore, we are confident that real GDP expanded by around 1 percent in 2013. Growth is projected to pick up further in 2014 to around 2 percent, in line with developments in Europe. Inflation continued to fall, dipping into negative territory in recent months, reflecting the still weak domestic demand and falling commodity prices. Going forward, inflation is expected to move closely in line with developments in the Euro Area,

reflecting BiH's currency board arrangement. Strong export receipts, rising tourist arrivals, and a steady inflow of remittances and foreign official financing have boosted international reserves.

Program Implementation

3. We have made further progress toward meeting our program objectives. All quantitative performance criteria for end-September 2013 on the budget balances of the Institutions of BiH and the central governments of the Federation and the Republika Srpska (RS) were met with considerable margins (Table 1). With lower-than-expected indirect tax revenues, sustained spending controls helped us to meet the fiscal targets. We can also report that the Institutions of BiH and the central governments of the Federation and the RS did not see an increase in domestic arrears in the period through end-September 2013. We also did not contract or guarantee any new non-concessional short-term external debt, nor did we accumulate any external payment arrears through end-December 2013. Similarly, the indicative target on net lending by the general government for end-September 2013 was met and the changes in the stock of other accounts payable for the general governments of the Federation and the RS remained substantially below their respective ceilings through end-September 2013.

4. Steps were taken to ensure that, despite the lower indirect revenue collection and a delay in the planned distribution of dividends from our electricity transmission company TRANSCO, end-2013 budget balance targets—as modified during the fourth review—would be achieved, and that the overall deficit for BiH would be contained to about 2 percent of GDP in 2013. To achieve these objectives, we maintained strict expenditure control, while we also started to implement a comprehensive set of measures (see below) to improve tax collection. The entity governments agreed on the implementation of the measures that would allow for the distribution of no more than KM 100 million in dividends from TRANSCO, but the process—including the associated legislative changes—could not be completed before end-2013. Before the distribution of dividends takes place, the entity governments will ensure that the company's management is fully functioning, audited financial accounts have been adopted, and an understanding has been reached on an investment plan that ensures the viability of the transmission system. The entity governments will seek the assistance of the EU to work out the details of the investment plan. We aim to complete this work—and the associated legislative changes—in early 2014. The distributed dividends will be used to repay debts or other liabilities incurred in 2013 or before.

5. In preparing our 2014 government budgets, our overarching objective has been to safeguard the progress we have made so far with fiscal consolidation, by strictly containing current spending and further improving revenue collection. Despite large pressures to increase spending,

we have managed to keep the spending envelopes in the 2014 budgets broadly unchanged from 2013, aiming to achieve a consolidated government deficit for BiH of slightly below 2 percent of GDP (excluding the one-off TRANSCO dividend distribution). Nevertheless, even with strict spending control and our efforts to improve revenue collection, we will have additional financing needs in 2014, especially towards the end of the year, as external debt service obligations will be even higher than in 2013 and revenues have not recovered as strong as had been envisaged at the start of the SBA. To avoid a sharp fiscal contraction that would cause substantial social hardship and undermine the still fragile economic recovery, we would like to extend the current arrangement and request additional financial support to help address these additional financing needs (see paragraph 19).

6. To demonstrate our commitment to sound fiscal policies 2014 budgets for the Institutions of BiH and the central governments of the Federation and the RS that are consistent with a consolidated general government budget deficit of just under 2 percent of GDP (excluding the one-off TRANSCO dividend distribution) were adopted by the respective parliaments in December (prior actions for this review and our request for an extension and augmentation of the arrangement). These budgets have been based on conservative revenue assumptions, and the central government budgets of the Federation and the RS target primary surpluses that combined are equivalent to about 1¾ percent of GDP. In addition, we are proposing quarterly quantitative targets for the budget balances of the Institutions of BiH and the central governments of the Federation and the RS for 2014 consistent with this objective as presented in Table 1, and we will also continue to refrain from accumulating new domestic expenditure arrears as defined in Table 1.

7. Further progress has been made in advancing our structural reform agenda in recent months:

- The new Law on Budgets for the Federation—aiming to enhance fiscal policy coordination in the Federation, promote fiscal discipline, strengthen the Federation central government’s oversight over lower levels of government, and improve fiscal reporting—was adopted by the Federation parliament in early December (a structural benchmark). The new law will become effective in January 2014. The work on enabling regulations and procedures to ensure its full implementation is well advanced.
- To enhance the transparency of indirect tax collection, the Indirect Tax Authority (ITA) published the list of 100 largest tax debtors on its website (an end-December 2013 structural benchmark). For this purpose, the Law on Indirect Taxation Procedure was amended to provide the ITA with the legal authority to publish such a list. The list will be updated on a monthly basis and we expect this step will help us improve the collection of tax debts. In

addition, the ITA has also started to publish monthly information on the stock of indirect tax arrears and the stock of rescheduled tax debts, as well as the debt rescheduling agreements, in a format agreed with IMF staff.

- The implementation of the new Law on Privileged Pensions in the Federation is underway. The audits to verify the eligibility of the existing beneficiaries are being carried out throughout the Federation and we have proposed to parliament amendments to the Law on Audits and the Law on Organization of Federation Ministries to improve the audit process. We have also unified and tightened the instructions for verifying the eligibility of new beneficiaries, and allocated sufficient administrative resources to ensure that the screening of new entrants will be completed within the prescribed deadlines. We have tasked the Federation Pension and Disability Insurance Fund (PIO) and the Ministry of War Veterans to investigate the reasons for the deviation between the expected and actual savings from the adjustment of benefit levels of existing beneficiaries and to report before end-January 2014. Meanwhile, the new law is currently under review by the Federation Constitutional Court. We will ensure that the overall cost of the privileged pension system will remain within the agreed upon amounts to safeguard the financial health of PIO, and we will take corrective measures as envisaged by the law as needed to achieve this.
- The pension reform strategy for the Federation and action plan, prepared with the assistance of the World Bank, was adopted by the Federation parliament. The strategy aims to increase the number of contributors and raise the effective retirement age to improve the financial sustainability of the pension system. We will submit changes to the relevant legislation to implement the strategy—the Law on PIO, the Law on the Organization of PIO, and the Law on Voluntary Funds—to the Federation parliament by end-December 2014 (a new structural benchmark) and we expect these amendments to be adopted by parliament by early 2015.
- In the RS, the rulebook on classification of household farms into commercial and non-commercial farms has been adopted. The process of registration of farms according to the new system was largely completed by end-2013. This will broaden the collection base for social contributions and thus help stabilize the financial conditions of the social funds in the RS. In addition, the classification of farms will also help us to better target agricultural subsidies.
- A new draft procurement law for BiH—prepared with the assistance of the OECD and the EU—was adopted by the BiH Council of Ministers in November 2013 and has been submitted to the BiH parliament. The new law will further strengthen our public

procurement framework by fully aligning it with EU standards. The new law in line with EU standards is expected to be approved by parliament by end-February 2014 (a new structural benchmark).

- Further progress has been made in improving our fiscal reporting and monitoring. Budget users in the Institutions of BiH and in the entities were instructed to enter commitment due dates into the Treasury system as of January 1, 2014. An agreement has been reached on a common definition of arrears in the Institutions and both entities, with any amount that is not paid within 90 days after the due date considered to be in arrears. With the adoption of the new Law on Budgets in the Federation, we will include foreign-financed projects and the road and highway funds in the reporting on the consolidated Federation general government. The RS, which had already started to capture foreign-financed projects in its reporting of the consolidated general government finances, will aim to complete this in 2014.
- All members of the Standing Committee on Financial Stability (SCFS) have been advancing their early warning and preparedness agenda by developing—supported by IMF staff—contingency plans detailing the responsibilities (within each member’s mandate and powers) of and the coordination between the relevant institutions in the face of severe financial sector difficulties (a structural Benchmark for end-December 2013).
- Also to help safeguard financial stability, and to mitigate potential risks to public finances, banks that have been under intensified monitoring by the banking agencies in 2013 have had to hire reputable external auditors to conduct thorough asset quality reviews (a structural benchmark for end-December 2013). We expect these reviews to be completed in the first half of 2014. The results from the reviews will provide valuable information to the banking agencies about potential balance sheet risks.
- In addition, as maintaining depositors’ confidence remains the centerpiece of a stable financial system, we have increased our deposit insurance coverage to KM 50,000 from KM 35,000, effective January 1, 2014. We had reviewed the capacities of our deposit insurance fund and our analysis confirmed that the insurance fund could comfortably withstand the increase.
- In the Federation, we addressed the legal uncertainty that had been created regarding the validity of the Securities Commission’s decisions resulting from the long delays in the appointment of new members of the commission by the adoption by the parliament of a

legally binding interpretation that affirmed the commission's decisions since early 2009. In order to ensure the stability of the commission and other institutions in the Federation going forward, we will work on a systemic and comprehensive solution by amending the Federation Law on Ministerial, Government and Other Appointments.

- We have prepared working drafts of new labor laws, both in the Federation and in the RS, with a view to making labor market legislation more conducive to job creation. To facilitate consensus building and improve the design of the new laws, we continue to consult closely with the employers' organizations and labor unions. We will seek—in cooperation with the social partners—to achieve that the new laws will: (i) require all collective bargaining agreements to be time-bound; (ii) give the government a larger role in determining the level of minimum wages—including for young workers; (iii) promote differentiated wage setting based on skills and performance; (iv) rationalize severance payments while strengthening social protection of the unemployed; (v) step up labor inspections and increase penalties for labor law violations; and (vi) protect workers' rights consistent with ILO labor standards and EC labor directives. We had aimed to have the new labor laws adopted by the respective parliaments by end-December 2013 (structural benchmarks), but as more time is needed for our dialogue with the social partners and parliamentary discussions this will slip into early 2014. This also caused a delay in the elimination of the take-home-pay protection in the RS as it is dependent on the adoption of a new labor law.

Further Reforms

8. The focus of our economic policies during the remainder of the program, including the period of the requested extension, will be to build on the progress made so far, by further reducing fiscal and financial risks, and fostering economic growth and job creation. Policies will be geared toward: (i) continued gradual and sustainable fiscal consolidation, with an increasing focus on improving revenue performance, streamlining the public sector, and preserving the gains from entitlement reforms; (ii) safeguarding financial sector stability through strengthening our legislative and regulatory framework and enhancing our capacity for supervision and contingency planning, as well as cooperation with home supervisors; and (iii) fostering the development of a vibrant private sector that can provide more jobs by improving the business environment. The key components of our policies are highlighted below.

Ensuring fiscal sustainability

9. Improving tax collection remains at the top of our policy agenda, and we will continue to pursue a multi-pronged approach. In particular, we will:

- Fully harmonize excises on different tobacco products. Excises on fine-cut tobacco will be raised to become fully equivalent with those on cigarettes effective March 1, 2014 (a new structural benchmark)—a decision to this effect was taken by the ITA governing board in December 2013—and we will ensure that the tax treatment of different tobacco products remains fully equivalent as we further raise the excise rate on cigarettes gradually in the coming years to achieve convergence with EU levels.
- Raise excise rates on fuel products and channel the additional revenues directly to the entity highway funds. This will help generate additional and much-needed resources for highway construction. Similarly, we plan to raise excises on alcohol and tobacco further, channel the additional revenues to the health care system, and initiate comprehensive health care reform with the assistance of the World Bank in the first half of 2014. This will also help us create the conditions for reducing the tax burden on labor by lowering the health care contribution rate over the medium-term.
- Complete the modernization of the structure of the ITA in the context of implementing the Rulebook on the Organization of Work Posts of the ITA. Specifically, we will strengthen the large-taxpayers unit and the unit focusing on the detection and prevention of VAT fraud.
- Introduce a risk-based approach for the selection of VAT refunds for audit, one of the key elements of our strategy to strengthen the control of VAT refunds and credits. We will develop the selection criteria to focus more on claimants' compliance records to the ITA and other tax agencies. Against this backdrop, we have requested IMF technical assistance to help us to make this strategy operational, with a view to fully implementing the new approach by June 2014.
- Benchmark our efforts with indicative targets on the gross collection of indirect tax revenues by the ITA (Table 1).
- Start the exchange of taxpayer information among the four tax agencies (ITA, FTA, RSTA, and BDTA) in January 2014. The working group in charge of implementing the Memorandum of Understanding on the sharing of taxpayer information that was agreed in 2013 is in the process of coordinating and finalizing the necessary legal and technical steps to be taken to provide the FTA, RSTA, BDTA, and ITA with automated and unfettered access to each other's taxpayer data.
- Adopt a new corporate income tax law in the Federation. A draft law is being prepared with assistance from the IMF, with a view to broadening the tax base and clarifying the tax treatment of depreciation and banks' loan loss provisioning. The new draft law will be submitted to the Federation parliament in early 2014, and its adoption is expected by end-March 2014. The law will come into effect January 1, 2015. The RS will also review its corporate income tax law in early 2014 in line with IMF recommendations, to foster consistency and with a particular focus also on its tax treatment of loan loss provisioning, as well as transfer pricing.

- Adopt the revised Rulebook on Tax Administration for the FTA. This will provide the FTA with the authority for its organizational design—including the establishment of a large-taxpayers office—and human resource management. With the assistance of the IMF, the FTA will press ahead with its modernization program, aimed at promoting voluntary compliance and implementation of a risk-based approach.

10. On the expenditure side, we will aim at streamlining and increasing the efficiency of government operations, focusing in particular on public employment and the benefit system. Thus, we will:

- Continue to contain the wage bill by refraining from increasing overall employment in the Institutions of BiH and the entity central government administrations.
- Draft new laws on civil servants and employees—following the adoption of the new entity labor laws—in the two entities as well as for the Institutions of BiH, with the assistance of the World Bank. The new laws, which we plan to submit to the respective parliaments within six months of the adoption of the new labor laws, will aim to facilitate public administration reform.
- Establish a centralized database in the Federation of all beneficiaries of social transfers. To this end, we will submit a new Law on Single Registry of Beneficiaries of Cash Payments without Contribution to parliament in early 2014, and we expect it to be adopted by parliament by end-March 2014 (a new structural benchmark). The database will become operational by end-April 2014.

11. We will restart the privatization process in the Federation, to help improve economic governance and competition, and reduce the risks to public finances. The Federation government—with the assistance of the EBRD and the World Bank—will submit to parliament a detailed action plan by end-June 2014, specifying the candidates for privatization, the timeline, and intermediate benchmarks for the next five years. In the meantime, we will start to dispose of our minority shares in a number of enterprises. The proceeds of these sales will be used to improve the Federation PIO's financial position—including by replenishing its legally mandated financial buffers and to settle part of state-owned enterprises' unpaid contributions to the PIO—and to facilitate the restructuring of other state-owned enterprises to prepare them for privatization.

Safeguarding financial sector stability

12. Our financial sector remains stable, despite the still difficult economic environment. However, we stay vigilant as credit growth remains weak and the quality of banks' loan portfolios has continued to deteriorate. We believe that the SCFS is the appropriate platform to coordinate our supervisory efforts and to share information. This provides the SCFS members with a more

comprehensive assessment of financial sector risks that will allow them to respond swiftly to any financial sector difficulties. On the basis of the SCFS members' contingency plans, and with the assistance of the IMF, we will review the rules and procedures of the SCFS, and amend the Memorandum of Understanding that governs the SCFS as needed, by end-March 2014, to ensure that the SCFS can effectively fulfill its coordinating role for contingency planning and crisis resolution. In this context, the SCFS will also conduct crisis simulation exercises, with support from the IMF and the World Bank, to drill down on the steps and communication needed to deal with events of a systemic nature.

13. In light of the supervisory and regulatory changes taking place in the euro area and in neighboring countries, it is crucial that BiH maintains close cooperation with foreign supervisory bodies. While our banking agencies currently benefit from an excellent dialogue with regional peers, the banking agencies plan to further formalize these exchanges by pressing ahead with the signing of Memoranda of Understanding with the relevant foreign supervisors in charge of overseeing the parent banks of subsidiaries currently active in BiH. We aim to have these memoranda signed by end-March 2014.

14. One of the key elements in our efforts to strengthen the legal and regulatory frameworks for our banking sector is to prepare new banking laws in both entities, with a view to bringing them fully in line with EU legislation and the requirements of Basel II, and to expanding the tool-kit for dealing with problem banks and clarifying the procedures for doing so. To ensure consistency between the entities, the entity finance ministries, the banking agencies, the central bank, and the deposit insurance agency will work with technical assistance from the IMF and the EU to coordinate the drafting of these new banking laws. We expect to submit the draft laws to the respective parliaments by June 2014 (structural benchmarks). In the meantime, to better protect consumer rights, in the Federation we expect to have the new Law on the Protection of Consumers of Financial Services adopted by the parliament by end-March 2014.

15. With non-performing loans (NPLs) continuing to increase, there is an urgent need to strengthen our monitoring and resolution framework. In parallel with our work on the new banking laws, and with the assistance of the IMF, we will also prepare new laws that regulate asset management companies (structural benchmarks for end-June 2014), a crucial component in the NPL resolution framework, and clarify the tax treatment of loan sales as needed. In addition, we will establish a voluntary out-of-court restructuring system in the first half of 2014, to promote the return of operationally viable companies to sustainable debt servicing. In this context, we will seek assistance from the World Bank to conduct an assessment of banks' NPLs to provide an estimate of the loans that could return to sustainable performance status through restructuring actions.

16. To help safeguard the integrity and stability of our financial markets, we have submitted a new draft law on AML/CFT to the BiH parliament, seeking to align our legal framework with FATF recommendations. We expect the BiH parliament to adopt this Law by end-March 2014.

Subsequently, we plan to review and amend as necessary related legislation, including the BiH Criminal Code, to ensure full consistency with the new Law.

Supporting a vibrant private sector

17. Job creation and inclusive growth remain key objectives of our policies. Besides reviewing our labor laws to make them more conducive to job creation (see paragraph 7), we are also improving the business environment to make it easier to start and operate a business and attract more foreign investment. In the RS, preparations for the establishment of a one-stop shop for business registration were completed and the new system is now fully operational. Subsequently, the process of business registration will be further streamlined by introducing online e-registration by end-June, 2014. With the same objectives, in the Federation new Laws on Companies and Inspections, and amendments to the Law on Business Registration, which were prepared with the assistance of the World Bank, as well as amendments to the Law on Offenses have been submitted to parliament, and we expect these to be approved in early 2014.

Program Modalities

18. We believe that our economic program continues to be on course and that our policies set forth in our Letter of Intent of September 11, 2012, and supplemented by the policies described in the Supplementary Letters of Intent of December 6, 2012, April 23, 2013, June 12, 2013, October 9, 2013, and this Supplementary Letter of Intent remain adequate to achieve the objectives of our program. We stand ready, however, to take any additional measures that may be needed to achieve the objectives of our economic program. We will consult with the IMF on the adoption of additional policy measures and in advance of any revision to the policies contained in our economic program, in accordance with IMF policies on such consultation. We will continue to provide IMF staff with the necessary information for assessing progress in implementing our program and will maintain a close policy dialogue with IMF staff. We will provide any necessary information to facilitate the safeguards assessment update.

19. As the consideration of this fifth review was delayed, we request the Executive Board to approve waivers of applicability of the end-December 2013 performance criteria on the budget balances for the Institutions of BiH and for the central governments of the Federation of BiH and the RS, and on the accumulation of domestic arrears by the Institutions of BiH and the central

governments of the Federation of BiH and the RS, for which data are not yet available and for which there is no evidence that these were not observed. We request the IMF Executive Board to complete the fifth review under the SBA and approve the sixth purchase under the arrangement in the amount of SDR 42.275 million. In addition, for the SBA to continue to provide an anchor for our economic policies during the period of political transition, to support the still fragile economic recovery, and to help to address the additional financing needs toward the end of 2014, we request the IMF Executive Board to extend the current SBA through June 30, 2015 and to augment the total access by 80 percent of quota (SDR 135.28 million), with 70 percent of quota to be disbursed in the second half of 2014. The program will continue to be monitored through quarterly (and continuous) quantitative performance criteria, indicative targets, structural benchmarks, and quarterly reviews. We propose quarterly performance criteria and indicative targets for 2014, as well as structural benchmarks for the period ahead in the attached Tables 1 and 2.

20. We authorize the IMF to publish this Supplementary Letter of Intent and its attachments, as well as the related staff report on the IMF's website following consideration of our request by the IMF's Executive Board.

/s/
Vjekoslav Bevanda
Chairman
of the Council of Ministers
Bosnia and Herzegovina

/s/
Nermin Nikšić
Prime Minister
Federation of Bosnia
and Herzegovina

/s/
Željka Cvijanović
Prime Minister
Republika Srpska

/s/
Nikola Špirić
Minister of Finance
and Treasury of
Bosnia and Herzegovina

/s/
Ante Krajina
Minister of Finance
Federation of Bosnia
and Herzegovina

/s/
Zoran Tegeltija
Minister of Finance
Republika Srpska

/s/
Kemal Kozarić
Governor
Central Bank of Bosnia and Herzegovina

Table 1. Bosnia and Herzegovina: Quantitative Performance Criteria and Indicative Targets Under the 2012–15 Stand-By Arrangement, 2013–14

(Cumulative flow since the end of the previous year; in millions of KM)

	2013						2014			
	End-June	End-September		End-December			End-March	End-June	End-September	End-December
	Act.	EBS/12/161	Act.	EBS/13/131	Adjusted	Act.				
Performance Criteria										
Floor on the net lending of 1/										
Institutions of BiH	51.9	-20.0	70.8	-5.0	-5.0	...	3.1	34.9	34.1	-10.1
Federation central government	154.7	120.0	184.7	174.0	116.0	...	42.2	183.7	234.9	246.9
RS central government	83.3	30.0	104.1	105.0	63.0	...	31.2	126.0	162.2	122.6
Ceiling on contracting and guaranteeing of new nonconcessional short-term external debt by										
Institutions of BiH	0	0	0	0	0	0	0	0	0	0
Federation general government	0	0	0	0	0	0	0	0	0	0
RS general government	0	0	0	0	0	0	0	0	0	0
CBBH	0	0	0	0	0	0	0	0	0	0
Ceiling on accumulation of domestic arrears by										
Institutions of BiH	0	0	0	0	0	...	0	0	0	0
Federation central government	0	0	0	0	0	...	0	0	0	0
RS central government	0	0	0	0	0	...	0	0	0	0
Ceiling on accumulation external payment arrears by 2/										
Institutions of BiH	0	0	0	0	0	0	0	0	0	0
Federation general government	0	0	0	0	0	0	0	0	0	0
RS general government	0	0	0	0	0	0	0	0	0	0
CBBH	0	0	0	0	0	0	0	0	0	0
Indicative targets										
Floor on the net lending of the general government of BiH 1/	60.4	-97.1	236.2	-17.1	-117.1	...	-7.6	241.9	167.6	175.2
Ceiling on changes in the stock of "other accounts payable"										
Federation general government	-94.7	100.0	-108.9	100.0	100.0	...	100.0	100.0	100.0	100.0
RS general government	-32.2	160.0	-82.6	160.0	160.0	...	100.0	100.0	100.0	100.0
Floor on the ITA gross revenue collection				6,056.0	6,056.0	...	1,395.0	2,957.0	4,649.0	6,297.0
1/ Excluding foreign financed projects as defined in TMU.										
2/ Continuous.										

Table 2. Bosnia and Herzegovina: Structural Conditionality

Actions	Test date	Status
Prior actions		
1 Adopt by the BiH parliament the 2014 budget for the Institutions of BiH, incorporating agreed measures		Met
2 Adopt by the Federation parliament the 2014 budget for the central government of the Federation, incorporating agreed measures		Met
3 Adopt by the RS parliament the 2014 budget for the central government of the RS, incorporating agreed measures		Met
Existing structural benchmarks		
1 Continue to adhere to the Currency Board Arrangement as constituted under the law	Continuous	Met
2 Refrain from introducing new privileged or special rights for retirement	Continuous	Met
3 Publish on the web site of the Institutions of BiH quarterly consolidated general government accounts with a 6 week lag	Quarterly	Met with delay
4 Carry out eligibility audits for war benefit recipients; publish results (quarterly within 4 weeks after the end of each quarter) of audits (Entities)	Quarterly	Met with delay
5 Adopt a new law on budget in the Federation that improves data reporting and enhancing control over lower level governments, extra-budgetary funds, and public companies	End-November 2013	Met with delay
6 Amend legislation in the RS to eliminate the take-home pay protection for public sector employees	End-December 2013	Not met
7 Adopt by the Federation parliament a new labor law with a view to facilitating job creation	End-December 2013	Not met
8 Adopt by the RS parliament a new labor law with a view to facilitating job creation	End-December 2013	Not met
9 Prepare the contingency plans for crisis preparedness and management in line with paragraph 10 of the supplementary Letter of Intent of June 12, 2013.	End-December 2013	Met
10 Publish a list of the 100 largest tax debtors to the ITA	End-December 2013	Met with delay
11 Hire reputable external auditors to conduct thorough asset quality reviews of the banks that have been under intensified monitoring by the Banking Agencies in 2013	End-December 2013	Not met (1 of 6 banks done)
12 Submit legislation in line with IMF staff recommendations regulating the establishment and supervision of asset management companies to the Federation parliament	End-June 2014	
13 Submit legislation in line with IMF staff recommendations regulating the establishment and supervision of asset management companies to the RS parliament	End-June 2014	
14 Submit to the Federation parliament a new draft law on banks and other lending institutions in line with IMF staff recommendations	End-June 2014	
15 Submit to the RS parliament a new draft law on banks and other lending institutions in line with IMF staff recommendations	End-June 2014	
Newly proposed structural benchmarks		
1 Raise the excises on fine-cut tobacco to be fully equivalent with those on cigarettes	March 1, 2014	
2 Adopt by the BiH parliament a new public procurement law in line with EU standards	End-February 2014	
3 Adopt by the Federation parliament a new law on Single Registry of Beneficiaries of Cash Payments without Contribution	End-March 2014	
4 Submit to the Federation parliament the amendments to the relevant legislation to implement the Federation pension reform strategy	End-December 2014	

Technical Memorandum of Understanding on Definitions and Reporting Under the 2012–2015 Stand-By Arrangement

January 8, 2014

1. This Technical Memorandum of Understanding (TMU) sets out the understanding between the authorities of Bosnia and Herzegovina and the IMF mission regarding the definitions of quantitative performance criteria and indicative targets for the Stand-By Arrangement (SBA) as well as data reporting requirements for program monitoring.

I. PERFORMANCE CRITERIA AND INDICATIVE TARGETS

2. In the following definitions, the end-quarter test dates apply to the last working day of each quarter.

3. The definitions of all fiscal variables contained in this TMU are based, unless otherwise specified, on the IMF's *Manual on Government Finance Statistics 2001*.

A. Floor on the Net Lending of (i) the Institutions of Bosnia and Herzegovina, (ii) Central Government of the Federation of Bosnia and Herzegovina, and (iii) Central Government of the Republika Srpska (Performance Criteria)

Definitions

4. The Institutions of Bosnia and Herzegovina comprise all spending units depending on its budget. The central government of the Federation of Bosnia and Herzegovina is defined to include all spending units depending on its budget whether these units are included or not in the treasury system. The central government of the Republika Srpska includes all spending units depending on its budget whether these units are included (entirely or partially) or not in the treasury system, and the operations funded by escrow accounts.

5. Net lending is defined as revenue minus expenditure.

Application of performance criterion

6. Program targets will be individually monitored quarterly through the respective accrual balances and measured as the cumulative change from the level existing on December 31 of the previous year.
7. For the purposes of program monitoring, compliance with the floor on the net lending will require that each of the three above-defined floors be observed independently.

Adjustors to performance criterion

8. The definition of net lending will exclude spending on investment projects financed by external official creditors either through loans or grants.
9. The floor on the net lending will be adjusted downward (upward) by the full amount of any shortfall (excess) in programmed dividend payments from Elektroprenos (Transco).

Reporting requirements

10. Data on monthly execution, including revenues, expenditure and financing, will be provided by the ministries of finance of the respective Entities and no later than five weeks after the end of each month (six weeks for end-year numbers). The Ministry of Finance of the Institutions of BiH will provide monthly data on revenue and expenditure no later than five weeks after the end of each month (six weeks for end-year numbers) and quarterly data on financing no later than six weeks after the end of each quarter.

**B. Floor on the Net Lending of the General Government of Bosnia and Herzegovina
(Indicative Target)**

Definitions

11. ***The general government of Bosnia and Herzegovina*** is defined to include the Institutions of Bosnia and Herzegovina, and the general governments of Federation of Bosnia and Herzegovina Entity (Federation), Republika Srpska Entity (RS), and the District Brcko. The *Federation general government* is defined to include the central government, the cantonal governments, the municipal governments, the federal and cantonal extrabudgetary funds and the road and highways funds. The *RS general government* is defined to include the central government, the municipal governments,

the extrabudgetary funds and the road and highway funds. The *District Brcko* is defined to include the central government with all spending units depending on its budget and extrabudgetary funds. Extrabudgetary funds include, but are not limited to, pension funds, health funds, unemployment funds, and children's fund. Any new budgetary or extra budgetary fund, created during the program period will also be included in the definition of the general government. The BiH authorities will inform IMF staff of the creation of any such new funds. Any fund that uses public resources not included in the definitions above will be automatically allocated either to one of the entity general governments or to the Institutions of Bosnia and Herzegovina. The BiH authorities will promptly inform IMF staff of the existence of any of such funds.

12. The net lending of the General Government of Bosnia and Herzegovina is defined as revenue minus expenditure. The floor on the net lending of the General Government of Bosnia and Herzegovina will be defined, for each test date, as the cumulative change from the level existing on December 31 of the previous year.

Adjustors to indicative target

13. The definition of net lending will exclude spending on investment projects financed by external official creditors either through loans or grants.

14. The target will be adjusted downward (upward) by the full amount of any shortfall (excess) in programmed dividend payments from Elektroprenos (Transco).

Reporting requirements

15. Data on quarterly general government execution, including revenues, expenditure and financing, will be provided by the ministries of finance of the respective Entities and District Brcko no later than six weeks after the end of each quarter.

C. Ceiling on Contracting or Guaranteeing of New Nonconcessional Short-Term External Debt by Institutions of Bosnia and Herzegovina, Federation and Republika Srpska General Governments, and CBBH (Performance Criterion)

Definitions

16. **Definition of debt.** The term “**debt**” is defined to include all current liabilities to non-residents, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments or CBBH to make one or more payments in the form of assets (including currency), at some future point(s) in time to discharge principal and/or interest liabilities incurred under the contract¹ (No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt, Decision No. 6230–(79/140), August 3, 1979, as amended by Decision Nos. 11096–(95/100), October 25, 1995, 12274–(00/85), August 24, 2000, and 14416–(09/91), August 31, 2009, effective December 1, 2009). In effect, all instruments that share the characteristics of debt as described above (including loans, suppliers' credits and leases) will be included in the definition.

17. **New nonconcessional external debt** is defined as including all debt (as defined above) contracted or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments or CBBH during the program period that is not on concessional terms.

18. **Concessional loans** are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest rates reported by the OECD (CIRRS). For short-term loans, the average CIRRS of the preceding six-month period (plus a margin of 0.75 percent) will be used.

19. **Short-term external debt** is defined as external debt contracted or guaranteed with an original maturity of up to and including one year

Application of performance criterion

¹ See [Debt Limits in Fund-Supported Programs—Proposed New Guidelines 6230-\(79/140\)](#)

20. The zero ceiling on contracting new nonconcessional short-term external debt applies to obligations of the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, and CBBH. This criterion will be measured quarterly on the basis of end-of-quarter data.

Reporting requirements

21. Data on newly contracted or guaranteed nonconcessional short-term external debt will be provided by the Ministries of Finance of the Institutions of BiH and the respective Entities and by the CBBH on a quarterly basis within six weeks of the end of each quarter.

D. Ceiling on the Accumulation of External Debt Service Arrears by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska General Governments, and CBBH (Performance Criterion)

Definitions

22. **External payment arrears** are defined as overdue debt service arising in respect of debt obligations (as described above) incurred directly or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, and CBBH, except on debt subject to rescheduling or restructuring.

Application of performance criterion

23. The zero ceiling on accumulation of external payments arrears applies to the change in the stock of overdue payments on medium- and long-term debt contracted or guaranteed by the Institutions of Bosnia and Herzegovina, Federation and Republika Srpska general governments, or CBBH. This criterion will apply continuously.

24. The limit on the change in external payments arrears also applies to the change in the stock of overdue payments on short term debt in convertible currencies with an original maturity of up to and including one year.

25. Accumulation of new external arrears is prohibited under the program.

Reporting requirements

26. The Ministries of Finance of the Institutions of BiH and the respective Entities and the CBBH will inform Fund staff immediately of any accumulation of external debt service arrears.

E. Ceiling on the Accumulation of Domestic Expenditure Arrears by the Institutions of Bosnia and Herzegovina, and Federation and Republika Srpska Central Governments (Performance Criterion)

Definition

27. The performance criterion established on the stock of domestic payments arrears contemplates a zero ceiling on the increase in the stock of arrears compared with the stock as of December 31 of the previous year. The stock of arrears is defined as the sum of payments obligations (accounts payable) past the due date stipulated by the contractual or legal payment period for each expenditure item and are nondisputed. They can arise on any expenditure item, including transfers to individuals, debt service, wages, pensions, energy payments and goods and services. Past-due payments obligations on inter-governmental transfers (i.e., transfers between Entity central governments and local governments, and extrabudgetary funds) are not included in the stock of arrears.

Application of performance criterion

28. The zero ceiling on accumulation of domestic payment arrears applies to obligations of the Institutions of Bosnia and Herzegovina, and Federation and Republika Srpska central governments. This criterion will be measured quarterly on the basis of end-of-quarter data. Thus, if at the end of any given quarter any of the three governments exceeds the zero ceiling on the change in the stock of its arrears compared with the stock of the same government's arrears as of December 31 of the previous year, the performance criterion will be missed.

29. **Reporting requirements:** Data on domestic arrears will be transmitted on a quarterly basis by the Ministries of Finance of the Institutions of BiH and the respective Entities within five weeks of the end of each quarter.

F. Ceiling on changes in the stock of “other accounts payable” by the Federation of Bosnia and Herzegovina and Republika Srpska General Governments (Indicative Target)

Definition

30. The accumulation of other accounts payable (Ostale obaveze) is defined as the sum of change in float and change in arrears. These can arise from any expenditure item, including transfers to individuals, debt service, wages, pensions, utility payments, and goods and services.

Application of the indicative target

31. The respective ceilings on changes in the stock of other accounts payable apply to obligations of the Federation of Bosnia and Herzegovina and of the Republika Srpska general governments as defined above. This target will be measured quarterly on the basis of end-of-quarter data. Thus, if at the end of any given quarter any of the two governments exceed their corresponding ceiling on changes in the stock of other accounts payable compared to the balance of the same government’s other accounts payable as of December 31 of the previous year, the indicative target will be missed.

32. **Reporting requirements:** Data on “other accounts payable” (Ostale obaveze) for the general government will be contained in the data on quarterly general government execution, including revenues, expenditure and financing, to be provided by the Ministries of Finance of the respective Entities no later than six weeks after the end of each quarter.”

G. Floor on the collection of gross revenues by the Indirect Tax Authority (ITA) of Bosnia and Herzegovina (Indicative Target)

Definition

33. Gross revenues of the Indirect Tax Authority are defined as the sum of revenues collected from (i) value added tax; (ii) customs duties, customs registration fees and levies; (iii) excise duties on imported products; (iv) excise duties on domestic products; (v) levies (toll) on oil derivatives; (vi) other proceeds and fees; (vii) sales tax; and (viii) unclassified revenues. Gross revenue collection will be defined, for each test date, as the cumulative sum of gross revenues collected since the beginning of the current year.

Application of the performance criterion

34. The floor on the collection of gross revenues by the ITA will be measured quarterly on the basis of cumulative end-of-quarter data. Thus, if at the end of any given quarter the cumulative amount of gross revenues collected since the beginning of the current year falls below the corresponding floor, the indicative target will be missed.

35. **Reporting requirements:** Data on gross and net revenues will be transmitted on a monthly basis by the Indirect Tax Authority within two weeks of the end of each month.

II. OTHER DATA REPORTING REQUIREMENTS

36. The Bosnia and Herzegovina authorities will report the following data to the Fund within the time limits listed below (Table 1). In addition, the Fiscal Council will provide, no later than the fourth week of each quarter, a summary of key macroeconomic policy decisions taken during the previous quarter; a summary of regulatory changes in the area of banking and financial sector, report any amendments to the Entity and state budgets within a week after their government approval.

37. Any revisions to past data previously reported to the Fund will be reported to the Fund promptly, together with necessary explanation. All data will be provided in an electronic form.

38. All magnitudes subject to performance criteria or indicative targets will be reported in millions of convertible marka.

39. The Bosnia and Herzegovina authorities will supply the Fund with any additional information that the Fund requests in connection with monitoring performance under the program on a timely basis.

